CHAPTER IV

PUBLIC REVENUE - JUSTICE OR EQUITY IN TAXATION

I. Theories about Equity or Justice in Taxation.

II. Progressive and Proportional Taxation.

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1. Theories about Equity or Justice in Taxation.

What is the idea of just taxation? A question of the greatest theoretical interest and practical importance in public finance. Numerous views. It is clear that equal amount of sacrifice from persons will not secure just tax - £1,00,000 — tax ₹50 - ₹100 & 50.

A. The Benefit Theory :- In proportion to benefits received.

Objection :- Mostly impossible. Most unable to pay.
Applies to fees & assessments & not to taxes.

B. The Equal Sacrifice Theory :- (Mill) - Equal sacrifice among tax payers. It is taken to mean equality of proportional sacrifice & not equality of absolute sacrifice by same amount :- Taxpayers should occupy same relative position they did before the payment of the tax. It is so framed that marginal utility of income of different taxpayers is affected in equal degree by taxation imposed.

'c. Edgeworth's Theory of Minimum sacrifice :-

Mill's views wrong.

Suppose 10 Rs from a man of Rs 800 a year & 1000 Rs from a 50,000 a year — Less sacrifice to take Rs 1000 from 50,000 Rs than 10 Rs from 100 men who get Rs 500 a year.

Ed. Theory has theoretical merits. But it cannot be followed. Fully. According to this highest income would disappear & the tax net thus income would fall on lower income,

CHAPTER IV

PUBLIC REVENUE - JUSTICE OR EQUITY IN TAXATION

I. Theories about Equity or Justice in Taxation:-

What is the idea of just taxation? This is a question of the greatest theoretical interest and practical importance in public finance. It is a question which has engaged the earnest attention of economists and statesmen all over the civilized world. There are numerous theories on this subject and some of these are given below.

It is clear that equal amounts of taxes from a rich man and from a poor man will not secure justice - for the rich man with an income of a lakh of rupees every year and paying a tax of Rs. 30 a year pays a very small percentage of his income, while a poor peasant with an income of Rs. 60 a year paying the same amount of Rs. 30 a year as taxation will have very little left for his own wants.

1) The benefit theory:-

The theory maintains that justice in taxation is secured by taxing each citizen in proportion to the benefit he receives from the activity of the state.

The benefit theory is open to the following objection:

In a certain sense the weak and the poor receive the

greatest benefit from the Government. In a modern progressive country like Britain they get free education and are, if necessary, maintained at the government expense. Though they receive the greatest benefit they are however least able to bear the burden of taxation; and it would be unjust and immoral to tax these poor men in proportion to the benefits received by them.

The benefit theory really applies not to taxes but to fees and special assessments which are levied in proportion to benefits received by persons making these payments.

2) The Equal Sacrifice Theory:-

Many writers like Mill maintain that taxation to be just, should cause equal sacrifice among the tax-payers.

Equal sacrifice is taken by some writers to mean equality of proportional sacrifice and not equality of absolute sacrifice. In other words the taxpayers after payment of the tax should occupy the same relative positions, which they occupied before they were taxed. So according to the equal sacrifice theory taxation should be so framed that the marginal utility of income of different tax-payers is affected in an equal degree by the taxation imposed.

This theory accepts the existing distribution of wealth as just and it holds that taxation to be equitable should leave present distribution undisturbed by imposing a proportional sacrifice upon the taxpayers.

3) Edgeworth's theory of Minimum Sacrifice:-
(Minimum sacrifice to the community as a whole).

J.S. Mill in advocating equality of sacrifice between individuals in the matter of taxation held that the principle of equality of sacrifice was fair to individuals and that it would lead also to the least sacrifice for the community as a whole.

But Mill was wrong.

Suppose that it causes equal sacrifice to take Rs. 10 from a man with an income of Rs. 500 a year and Rs. 1,000 from a man with an income of Rs. 50,000 a year; but even then it will cause less sacrifice to the community to take Rs. 1,000 as taxation from one man with an income of Rs. 50,000 a year than to raise the same sum of Rs. 1,000 in taxation by taking Rs. 10 from each of one hundred men with an income of Rs. 500 per head per annum. This is the substance of Edgeworth's theory of minimum sacrifice or the least aggregate sacrifice to the people as a whole.

Edgeworth's theory of minimum sacrifice has substantial theoretical merits; but it cannot be followed as a practical policy. If following this theory taxation rising to 100

D. The Faculty Theory :- Justice in taxation by following faculty a ability principle. Taxation is to be levied on persons in proportion to their faculty a ability to pay & not in proportion to benefits received by them.

People with ~~,~~ and able to earn large incomes, should be taxed heavily.

~~Poor~~ do " " " " " " Small " " " " " " Slightly.

Faculty is a better criterion than benefit.

How is faculty to be measured?

(a). Mill & others measure faculty to pay taxes by sacrifice involved in tax payment

(b). Some suggest faculty to be measured by Consumption — Rich live more luxuriously

(c) Property as the measure of ability. Property differs greatly in productive uses.

(d). Income is the best measure of ability :- This view is least open to objection & most widely accepted.

∴ Income as a measure is not entirely satisfactory because (1) incomes are not equally permanent

(2) Two persons of equal incomes one may have a larger family etc.

It is however impossible to find a better measure of ability than income. The only cure is to levy taxes on income & where the taxpayer receives it by varying rate of tax & by other ways.

per cent was concentrated on the highest incomes, such incomes would disappear and then taxation would fall on the lower incomes; and such heavy taxation of the highest incomes would check the growth of capital and production of wealth in the country.

Pigou's discussion of the rival claims of least aggregate sacrifice and equal sacrifice as ultimate principles of taxation is interesting and important.

4) The Faculty Theory:-

Many economists are of opinion that justice in taxation can be secured by following the faculty or ability principle. Taxation should be levied upon persons in proportion to their faculty or ability to pay and not in proportion to benefits received by them.

In theory it is just that men should be made to help the state revenue in proportion to their power to help themselves.

Persons who can earn large sums for themselves and so have ability to pay heavy taxes should be made subject to heavy taxation though these persons may not derive much direct benefit from the taxes; and the poorer classes who cannot earn much for themselves have comparatively less ability to pay and so they should be taxed lightly though they may derive much direct benefit from the proceeds of

taxes. Faculty is a better criterion than benefit.

Now how is faculty to be measured?

(a) Mill and others will measure the faculty or ability to pay taxes by the burden or sacrifice involved in tax payments.

(b) Some suggest that faculty is to be measured by consumption. This view is not satisfactory because the consumption of the poorer classes is greater than their ability to pay and the consumption of the richest classes is less than their power to contribute to the state revenue.

(c) Again other people suggest that property is the true measure of ability. The objection to this is that property differs greatly in productiveness, and that a man with a small property may have a large income and consequently great ability to bear taxation.

(d) Then there is the view that income is the best measure of ability. This is the view least open to objection and most widely accepted.

Of course income as a measure of ability is not completely satisfactory in every way. This is because equal incomes are not equally permanent and so do not measure the same ability and also because of two persons with equal incomes one may have a larger family to support and so may

have less ability to bear taxation.

It is impossible however to find a better single measure of ability than income; and the only course open to us is to levy taxes on income and in cases where it leads to injustice to remove the injustice either by varying the rate of the tax or by inheritance and in other ways.

II. Progressive and Proportional Taxation:-

If the rate of taxation remains the same for all incomes (or property) large or small, then we have proportional taxation. When there is a proportional tax of 3 per cent on incomes, then an income of Rs. 300 would pay Rs. 9 (3 X 3 = 9) as taxes, an income of Rs. 500 would pay Rs. 15 (5 X 3 = 15), an income of Rs. 1,000 would pay Rs. 30 (10 X 3 = 30) and so on.

If the rate of taxation increases as the income (or property) increases, then we have progressive or graduated taxation. (Suppose the rate of taxation is 3 per cent for Rs. 100, 4 per cent for Rs. 1,000 and above, 5 per cent for Rs. 10,000 and above, and higher rates of taxation for larger incomes then we have progressive taxation).

We thus have proportional and progressive taxation of income; and also proportional and progressive taxation of property.

Justice in taxation is attained by levying taxes according to the faculty of tax-payers.

The faculty theory leads directly to the question of progressive and proportional taxation. Now which is the better measure of faculty? A proportional rate of taxation or a progressive rate of taxation?

If the rate of taxation diminished as the income or property increases we have regressive taxation; and if the rate of taxes increases faster than the income or property but towards a fixed maximum rate, which it can never exceed, it is known as degressive taxation.

Arguments in favour of Progressive Taxation:-

(a) Most economists are agreed that the ability of a person to pay taxes increases more than in proportion to the increase of income or property; and so following the ability theory, the rate of taxation should be higher for larger incomes or larger properties. The justice of progressive taxation follows naturally from the ability or the faculty theory.

Progressive Taxation gets strong theoretic support from the marginal theory - "It was not until the marginal theory was thoroughly worked out on its psychological side that progressive taxation obtained a really secure basis in

principle ..... the principle is based upon the diminishing utility of money or wealth as a whole to its possessor" says Sir Josiah Stamp.

(b) Progressive taxation has also been defended on the ground that the larger the income the greater is its power for the production of further income.

(c) Progressive taxation is justified by certain writers by reference to the 'rental' conception in economic theory.

According to Mr. J.A. Hobson, the price or reward of a given factor in production, whether interest or wages, is fixed by the reward payable to the marginal supplier and the superior reward paid to a person with a position of advantage is in the nature of economic rent, and as its withdrawal would not lead to the withdrawal of the supply, it is capable of bearing taxation without further shifting. This is Mr. Hobson's doctrine of the taxation of surplus - costs cannot be taxed in theory and only the surplus (or the rent element in wages, interest and profit) can be taxed without further shifting. And Mr. Hobson assumes that these rental or surplus elements are more likely to exist in the incomes of larger amount and therefore progressive taxation of income is roughly taxation of surplus.

(d) Progressive taxation has been also justified as an instrument for social improvement.

According to certain writers the present distribution of wealth is unfair to the mass of the people and the labouring classes; and the State by means of progressive taxation might make society better for the people at large than it is now, through increasing public expenditure on old age pensions etc. In Professor Marshall's words, the State is "to use its powers for prompting such economic and social adjustments as will make for the well-being of the people at large".

A moderate degree of progression should be aimed at. Very high progression will be perhaps unjust, arouse great opposition from the rich and propertied classes, check the accumulation of capital, slacken the energies of industrial leaders and retard industrial progress. The progressive rates of taxation should never exceed (and perhaps should never reach) 100 per cent on any part of income.

The subsistence minimum must be exempted from taxation.

The aim should be progression for the taxation system as a whole - stronger progression might be necessary in the case of one tax so as to counteract the injustice and injurious effects of other taxes.

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